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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE outbreak of another acute crisis in Europe, and the accompanying market unsettlement in this country, have made March a generally disappointing month to observers of the business situation. Many business men had hoped that the arrival of Spring might bring signs of resumption of last Fall's upswing; and early in the month a pickup in buying in a number of lines, together with firmness in commodity prices, furnished some support for these hopes. However, the improvement has made little headway. On the whole factory operations have not made as much seasonal gain as usual, and when the month's figures are compiled the adjusted indexes of industrial production, which allow for seasonal expectations, probably will show a small decline for the third month in succession. Nor have the industries been provided with a backlog of orders sufficient to promise any marked rise in April.

Testimony as to business sentiment over the country indicates that it is conservative, although not pessimistic. Expectations that the sidewise trend will sooner or later give way to improvement are common, but little is being done in anticipation. Naturally the menace of a European war, or of recurring crises which disturb markets and lead to new disorders in trade, influences business men to keep commitments down. It is possible to argue that after the first shock the effects upon this country of a European war would be more stimulating than otherwise, but no one knows this for certain, and every one is aware that the eventual result would be an indescribable calamity, leaving a burden of suffering and disorder which would disrupt the economic life of all countries. As in the crisis of last September, business men all over the world have been concerned with protecting themselves against new difficulties and risks, and this attitude leaves little scope for the needed expansion of long-term planning and investment.

It is no cause for congratulation that the crisis has again speeded up the movement of gold into this country to the volume of last September. This gold represents the continued flight of capital from countries where political and economic conditions are insecure to the place where it can obtain security, even at the cost of remaining idle. This flight of capital from productive employment is the most depressing factor in world business. To this country the inflow is a menace, in view of the inflationary danger and the possible disturbance in case the funds are invested temporarily and later withdrawn. If it were offered peace and security in the countries where it is needed, this capital would revive production and trade, absorb unemployment, and raise prices of staple commodities; while in this country it is unneeded, unwanted and ineffective. It is not a stimulant to the business situation, but the contrary, for it is a symptom of world disorder which is impeding our recovery.

Business Conditions Abroad

Prior to the German move into Czechoslovakia there were encouraging indications in reports of business conditions abroad. The French situation had continued to improve. In Great Britain the industrial production indexes had turned upward, the increase in employment in February was greater than normal, and the advance on the London Stock Exchange, which set in during February, had continued strongly. The situation in Great Britain is an important influence on conditions in many other countries; and a natural turn for the better, following the improvement in the United States, would hold promise of greater purchases of raw materials, and a stimulus to prices and general activity in areas which are important markets.

It is too early to say what the effects of the crisis upon the British trend will be. The Stock Exchange has reacted, but prices hold well above the lows. There are signs of hesitation in other quarters. The encouraging element is that business has shown readiness to improve, and therefore should resume the upgrade if the war fear abates.

One certain effect of the crisis, which applies to the Continental countries as well as Great Britain, is that armament programs will be expanded and pressed forward vigorously. It is recognized that this gives support to business, and maintains employment and consumption; on the other hand, the expenditure is financed everywhere by an increase of debt which is spreading anxiety, alarming capital, and discouraging private enterprise.

The Domestic Situation

The domestic business reports reveal both the strength and weakness of a period in which conservatism prevails and hand-to-mouth buying is a common policy. Evidently business is still at a dead center, with strong supporting elements, but thus far lacking the influences needed for a vigorous forward movement.

The conditions which usually precede an important drop in activity are little, if at all, apparent. The caution in buying policies has kept the markets in good order. Speculative activity has been at a minimum. Indications in trade channels are that goods produced with few exceptions have moved regularly into consumption, and consumption is supported by a national income which seems unlikely to be diminished in the near future. Manufacturers' stocks of raw materials are low, according to most evidence, and stocks of manufactured goods are not excessive in relation to sales. There has been no considerable advance in prices or appreciable rise in living costs.

Industrial costs have not increased to a threatening extent, but rather the contrary, for the higher volume has reduced unit costs. Since the Spring of 1937, when the advance in wage rates was one of the causes of the business setback, the industries have made great progress in adjusting to the higher scales, by increasing efficiency and labor productivity; and the general testimony now is that they are operating efficiently, with a satisfactory output per man hour and labor disturbances lessened. The reduction of industrial costs is the source of all economic progress, for only through efficient operations can wage rates be supported, a return provided for capital, and prices set that will broaden consumption. Conversely, a rise in costs usually precedes a business reaction.

Farm income is supported by Government payments, and for the first two months of this year was slightly larger than in the corresponding period of 1938. Moreover, total Government disbursements will be increasing for some months to come, and evidently will not reach the peak before mid-Summer.

All these are supporting elements. They are to be taken into account in estimating the effect of shocks from abroad. If consumers should be impelled by fear to reduce their buying the consequences naturally would spread; but as a rule disturbing political events react on business more through a decrease in business spending than through consumer spending, and the volume of business spending is already low, for reasons only partly connected with the foreign situation. Retail trade has improved since the middle of February except where unfavorable weather has interfered, and the general opinion is that the Spring season will be satisfactory. In the four weeks ended March 25, according to Federal Reserve reports, department store sales were 4 per cent over a year earlier, although prices are a little lower, and the gain in mail order and chain store sales apparently has been greater.

The Position in Consumers' Goods

But although the consumer goods industries are giving support it is hardly to be expected that they will lead in moving business off its dead center. They had a phenomenal improvement in the second half of 1938 and for some time have been producing as much as their markets require. The automobile industry in December reached a production and sales rate which, if projected according to the usual seasonal trend, represented close to a 4 million car year. There was never much reason to think that this rate would be bettered, nor much room for disappointment if it is not fully held. Through January and February sales came up to expectations. In the early part of March they made the usual gain over February, but lately are reported to have slackened somewhat. Dealers are well supplied, and assembly rates in March have been increased less than seasonally.

Likewise, the textile, shoe and paper industries, considering their activity in recent months, are unlikely to give a fresh start to business. The outlook for cotton manufacturing is under the shadow of a tight supply of spot cotton, due to the impounding of more than 11,000,000 bales in the Government loan; some qualities are becoming scarce, and mills are unable to get prices for their goods which would permit them to pay the prices necessary to dislodge cotton from the loan. Moreover, there are few signs so far that legislation to facilitate releases from the loan this season will be passed. Cotton futures are cheaper than spots, and there is general uncertainty as to the value of the next crop, in view of the conflicting plans for dealing with it that the Government is considering. This discourages forward buying all along the line. Thus the outlook for mill operations toward the end of the season is uncertain, and talk of curtailment is increasing. On the other hand, supplies of goods and mill stocks of cotton will be low on August 1 next, when the new season begins, and a strong pickup then is possible if the new crop comes on the market at a price which inspires confidence.

Silk weaving has been curtailed drastically, following the sharp rise in raw silk prices, but this loss may be made up by a compensating increase in rayon cloth production. Woolen mill operations are holding at a high rate and a satisfactory season is expected for the Fall lines now opened.

Steel mill operations have moved irregularly but the main trend has been slightly upward. The supporting factors are the orders in hand for structural steel, rails and track equipment, and shipbuilding materials, plus the seasonal advance in automobile output and a moderate improvement in tinplate. New buying has been sluggish. However, consumers' inventories are reported low enough to promise a steady demand. The strong point in the situation is that both buying and production have been keyed closely to consumption.

Business Planning is Conservative

Evidently it is necessary to look beyond the consumer goods lines for influences that may start another forward movement going; and this simply repeats the conclusion that all analyses of the situation have drawn since last December, namely, that only a rise in construction, machinery and equipment activity will supply a fresh impetus. These industries have improved during the first quarter, but of course are the ones most affected by political shocks and trade disturbance.

Building contract awards for the first half of March included fewer large projects than usual, and averaged lower than in February although a sharp seasonal increase generally occurs. However, figures for the third week more than made up the loss. The month's total promises to be the highest for any month since 1929 in residential building, and in other classifications it will rank well with any period since 1931, except those in which Government contracting was abnormally active. Applications for mortgage insurance to the F.H.A., and the progress of P.W.A. and U.S.H.A. plans, warrant a continuing favorable interpretation of the outlook.

Machine tool orders have been increasing each month. In February they were more than double a year ago, and the early part of March also made a good showing.

These figures would be encouraging if there could be assurance that the pickup would carry on, for undoubtedly continued gains in these lines would soon turn the general trend upward again. However, policies with respect to capital investment, and new plans and projects of all kinds, are conservative; and unfortunately March has not been a month to supply any great optimism. Its developments seem to imply a continuation of the period of marking time, on a level, however, which is well above a year ago, and at which most businesses can make some profit.

Money and Banking

Inasmuch as gold and international capital movements are discussed separately in a following article, reference to money conditions may be brief at this point. Apart from the gold movement, the most interesting developments of the month were a rise in United States Government bond prices to new high levels, and an increase in bank deposits to a new peak on bank purchases of securities and inflow of funds from abroad.

Surplus reserves of member banks continued to range somewhat under the peak of $3,600,000,000 reached at the end of January, but with the surplus of funds as large as it is now a loss of several hundred millions in reserve funds means nothing to the market, especially when traceable largely to temporary influences, as has been the case recently. Since the end of January, Treasury balances in the Reserve Banks have been running abnormally high, in excess of $1,000,000,000, due to temporary accumulation of funds (including March tax collections) in excess of disbursements, and this, of course, has taken funds from the market. However, as it is only a question of time before Treasury balances in the Reserve Banks are paid out again, the really significant feature of the money situation is the gold inflow, which is adding steadily to bank reserves and so strengthening the basis of easy money. In the final week of the month excess reserves rose sharply to within $80,000,000 of the peak.

Currency "in circulation" continues to show non-seasonal increases, and is now over $400,000,000 greater than a year ago. Evidently the situation in Europe is a factor, inducing hoarding abroad of United States bank notes, which has called for substantial shipments from this country.

Commercial loans of reporting banks recorded a mild seasonal advance during February and March, aggregating in all $60,000,000 to March 22, but even so the total outstanding remained $500,000,000 lower than a year ago. With normal outlets for banking funds restricted, the pressure upon banks for earnings was reflected in a further rise in holdings of United States Government securities to a new high since 1937.

The Continuing Inflow of Gold

With the more critical turn of the political situation in Europe during the past month, the flight of capital to this country, which had subsided measurably after Munich, has again increased. Although exchange rates have held much steadier than during the September crisis, being supported by the various stabilization funds, the tide of the gold movement has swelled again to proportions rivalling those of last Fall. During March gold imports thus far

reported totaled about $340,000,000, including $116,000,000 on the 31st, a new high record for a single day.

As has been true for some time past, Great Britain continues to be the chief source of our gold imports, with the Netherlands following second. However, after nearly two years suspension, gold has been again received from Switzerland and the proceeds added to the large total of Swiss balances already on deposit here. Anxiety over the course of events in Central Europe has been growing more acute in Switzerland, and only recently the Swiss Finance Minister announced a program of expenditure, largely for defense, that is expected to triple the national debt. Not only does the impulse to get capital out of Europe embrace private individuals, but foreign central banks and governments are continuing to build up deposit balances and earmarked gold stocks in this country; also foreign stabilization funds undoubtedly have found exchange supporting operations costly, thus contributing to the gold inflow.

Counting earlier receipts, imports of gold for the year to date have exceeded $700,000,000, and if we go back nine months to last July before the development of the first Czechoslovakian crisis, it is startling to realize that gold imports have reached a total value of nearly $2,500,000,000, or more than the total value of gold imported during the entire war and post-war period from 1914 to the end of 1929. True, in making these comparisons, allowance must be made for the change in the price of gold. Even so, the total is prodigious, and it must be remembered that it is the dollar value of the gold stock rather than the quantity in ounces that is significant from a reserve standpoint, since it is upon the dollar totals that the potential expansion of credit and currency must be reckoned.

The following table shows the amounts and principal sources of gold imports into the United States, by months, since last Summer,

United States Net Gold Imports
(In Millions of Dollars at $35 an Ounce)

Date	U.K.	France	Netherlands	Sweden, Switz., Belg.	India, Canada	Japan	All Others	Total
1934	500	260	94	21	164	....	93	1,132
1935	316	934	227	1	170	....	91	1,739
1936	174	574	71	11	151	....	136	1,117
1937	892	–14	6	145	162	246	149	1,586
1938	1,209	81	163	77*	92	169	183	1,974
1938								
July	5	1	....	8	2	29	19	64
Aug.	91	5	....	18	14	23	15	166
Sept.	378	....	47	12	38	35	11	521
Oct.	443	43	42	4	11	6	13	562
Nov.	99	....	27	1	11	6	34	178
Dec.	102	38	46	2	3	14	36	241
1939								
Jan.	52	1	34	2	11	38	18	156
Feb.	165	....	29	....	4	....	25	223
Mar.†	......	....	....	....	....	....	....	338

* Belgium sent us in 1938 $16,000,000, Sweden $60,000,000 and Switzerland $1,000,000. † Preliminary.

with annual figures back to the beginning of 1934 when the dollar was formally devalued and stabilized at its present level. Altogether, over this period of less than five and a quarter years, this country received over $8,000,000,000 of gold, a sum exceeding the total gold holdings of the central banks of the entire world at the end of the war, valued in the dollars of that time.

Factors in Gold Inflow Since 1934

In an analysis of the huge gold movement since 1934, contained in the February number of the Federal Reserve Bulletin, the principal influences are indicated to have been (1) a surplus of merchandise exports over imports amounting to $2,100,000,000 over the period, and (2) a capital movement amounting in the reported figures to around $4,200,000,000.

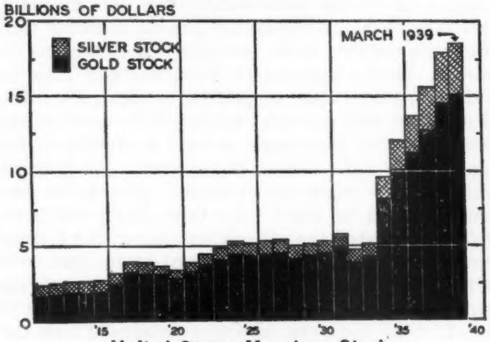
Of the net capital inflow of $4,200,000,000, somewhat more than a third is found to have represented repatriation of American capital previously held or invested abroad. Somewhat less than a third is stated to have represented foreign buying of American securities, and the balance has gone to increase foreign bank balances and short-term investments in this country.

In view of apprehensions frequently expressed as to the possible effects upon our market of large scale withdrawals of foreign capital, it is interesting to note the Reserve Board's conclusion that "while this inflow (of capital) has been influenced to an important degree by disturbed conditions abroad, only a limited amount now represents nervous foreign money ready to leave this country as soon as conditions abroad become more stable." In support of this view, the Board produces data, based on Treasury and Department of Commerce statistics over a period since 1926, showing that while foreigners as a group bought securities here during bull markets they have not sold on balance during subsequent declines. The volatile elements in the situation have been in the foreign bank balances and short-term investments which have constituted the real "hot money," and which move readily in response to shifting political or economic conditions. As indicated by figures cited, however, the growth of these balances has accounted for only a little over a third of the inflow of capital since 1934, and probably not all of this can properly be called floating balances, since these totals include working balances of foreign business concerns in this market which had been abnormally reduced during the time prior to 1934 when the dollar was being depreciated.

Gold Stocks Pass $15,000,000,000

Reflecting the continuing heavy imports, together with rising domestic production, gold stocks owned by the United States rose above $15,000,000,000 in March, representing the greatest store of the metal ever held by this

or any other country. At the present time this country holds approximately 60 per cent of the publicly reported gold stocks of the world, compared with something like 35 per cent at the end of 1933 just prior to the devaluation of the dollar, around 39 per cent at the end of the war and about 30 per cent at the end of 1913. In calculating the ratio for 1939, however, no allowance has been made for gold held in various foreign stabilizations funds, and in private hoards of western countries, which, if included, would reduce our proportion somewhat, probably to about 50 per cent.



United States Monetary Stock
(Gold carried at $20.67 an ounce prior to Jan. 31, 1934; subsequently at $35. Silver carried at coinage rate of $1.29 an ounce).

Will Gold Be Demonetized?

The gold acquisitions of the United States, recently and over the last five years, have been so extraordinary as to prompt extraordinary comments and questions. "Is it possible," is asked, "that the rest of the world, having sold its gold to the United States, may proceed to demonetize it; and if so, what will it be worth to us?"

The answer is that there are very good reasons for believing, first, that the world will not sell all its gold to the United States; second, that gold will not be demonetized and will always be in demand in all countries. In short, the present situation does not signify any loss of the qualities for which gold has been prized in the past. Its significance is quite the contrary. The best reason for thinking that gold will be wanted is that there is nothing to take its place. Silver has been gold's only rival since the time of Abraham, and under the Silver Purchase Act the United States is absorbing silver also. No other country is importing silver for use as money, and fiat money is more than ever out of favor. The gold coins of Spain and Czechoslovakia are good under any flag. Barter as a primitive practice was long ago supplanted by the use of silver and gold, and in any modern practice needs the aid of gold, as Germany will testify. The discount on "aski" marks is proof of this. Secretary Morgenthau is fully justified in the following comments in a letter to Senator Wagner recently made public:

> Some countries (operating with very little gold or foreign exchange assets) have been pointed to as illustrations of the phenomenon that countries can carry on foreign trade and settle international transactions without resort to gold, and that gold is rapidly becoming obsolete even for this monetary role. Those who make this claim completely misread the experience of these countries.
>
> These very countries do in fact need and prize gold more and seek it more anxiously than do countries that use gold freely to settle balances of international payments. It is their inability to obtain gold which forces them to adopt a far less satisfactory alternative method of adjusting their balance of international payments—namely, the adoption of strict exchange control, of clearing agreements, of barter schemes, and the imposition of severe penalties against evasion and all the other business and liberty destroying procedures necessary to make the system work.
>
> There is no one thing which demonstrates more effectively the superiority of gold as a means of settling international balances than the experience of those countries that have tried to get along without it.

As the Secretary also pointed out in his letter, "the nations producing substantial quantities of gold have important vested interests in the continuation of gold as a monetary metal. The British Empire alone produces almost half of the world's gold. Even countries that produce relatively small amounts of gold find that those small amounts are an important source of national income to them."

Before the war the principal functions of the gold standard were as a measure of value and means for settling international balances, and therefore a suitable and safe basis for domestic currencies, however "managed." The essential consideration is that no other form of wealth is so readily moved from country to country, or so readily exchanged for other forms of wealth, as gold. The very transfers of gold that are the immediate subject of comment are proof of this.

For many years prior to the world war trade and capital movements between gold standard countries were as simple, as free of risk and almost as inexpensive, as within our own country. Furthermore, notwithstanding currency disorders, and even in fact because of them, gold remains an indispensable factor in international relations, and therefore a factor in domestic affairs.

The Status of the Dollar

Early in President Roosevelt's first term, May 12, 1933, Congress, yielding to popular pressure induced by the fall in agricultural prices, passed the Thomas Amendment to the Agricultural Adjustment Act, authorizing the President to devalue the unit dollar up to 50 per cent of its gold content. In January, 1934, the President submitted a draft for a new monetary act, providing more specifically for devaluation, and authorizing the President to determine the reduction with minimum and maximum limits at 40 and 50 per cent; also providing for an exchange stabilization fund of $2,000,000,000 out of the "profit" derived from revaluing the gold stock. The President fixed the

gold content of the dollar at 13.71 grains, which compares with 23.22 grains in the former dollar, a reduction of 40.94 per cent.

The Act also provided that the power granted would expire in two years, but that the President might extend it for one year more, which he did; furthermore, on January 25, 1937, he approved an act of Congress extending it to June 30, 1939. During the present session of Congress, the Secretary of the Treasury has appeared before Senate and House Committees to advise a further extension, and also to recommend that the stabilization fund be extended concurrently, as heretofore.

The argument for both proposals is that this was emergency legislation and that the emergency still exists. In 1933-34, Great Britain and other nations were off the gold standard; none of these nations has as yet reestablished the gold standard, political and social disorders are prevalent, and exchange relations continue uncertain. In view of these conditions it is urged that prompt executive action may be desirable to protect the national interests, or at least that the possession of such power by the President will be a deterrent of competitive devaluation by other countries.

In support of the plea for extension, assurance is given that use of this authority is not at present contemplated, or regarded as probable. Indeed, the $15,000,000,000 gold reserve, the redundant supplies of money and credit, the Tripartite Agreement, the general approval of the policy of a fixed price for gold, and the Administration's expressed satisfaction with this policy, all give reason for believing that the authority is wanted only as a safeguard and not for probable use.

On the other hand, the act of extending this authority gives public notice that uncertainty will continue to exist as to the policy of the United States regarding its standard of value, and public confidence on this subject is of great importance. It is to be said with approval that for five years the Administration has held to a consistent gold policy. Secretary Morgenthau said in his testimony to Congress that whenever he had talked to anyone "in a dispassionate, non-political atmosphere," he found approval "of our record in the past five years in regard to the dollar and gold as a definitely stabilizing influence."

It is unfortunate that the Secretary of the Treasury has repeatedly found it necessary to deny rumors that the Treasury gold price was about to be changed, one way or the other. It has been evident later that no foundation for these rumors existed, but whether they were surmises based on circumstances, or deliberate fabrications, they were disturbing to the business world. Moreover, such incidents are bound to occur where a matter of such public importance remains in a state of suspense. And this matter is of especial importance now in view of the state of business.

Present uncertainty presumably relates only to the remainder of the 50 per cent devaluation originally authorized inasmuch as revaluation upward would not only be contrary to present law but probably also impracticable politically.

The circumstances leading up to the original devaluation are of importance now only as they may give light on the present situation. The breakup of the gold standard did not begin with the action of this country. Currency depreciation was widespread and the United States faced the bewildering problem of maintaining exports, restoring prices, dealing with unemployment and reducing the burden of debts. In the opinion of Congress the Thomas Amendment was a sweeping remedy. The President did not act under all its provisions, but accepted this one. It was a drastic action to cut the dollar over 40 per cent, for it could not fail to react upon other currencies and markets. It is not likely that Congress carefully calculated the effects outside of the United States, but may have thought it in line with what others were doing. The effects at the time were less than expected, or not of the same kind. Our exports of farm products did not increase as hoped for. Farm prices have been up and down, at present being below the 1909-1914 average, notwithstanding the money devaluation. Droughts, crop restrictions and government loans to support prices have been the most important influences.

Apparently the most direct effect of devaluation was to start the drain of gold from Europe to this country that has been coming ever since. This weakened the nations of Europe that were struggling to maintain the gold standard. Immediately following the United States, Czechoslovakia reduced its gold unit; in March, 1935, Belgium reduced its unit 28 per cent, and in September, 1936, France put into effect its second formal devaluation, causing the Netherlands and Switzerland to readjust their gold parities. Italy yielded also. As each nation of the old gold bloc gave way, the pressure on the remaining members increased.

Secretary Morgenthau, in his letter to Senator Wagner, commented on the gold inflow in part as follows:

> We are confronted with the fact that though we should like to receive less gold and even to get rid of substantial amounts of the gold we already have, there is, under the existing circumstances, no acceptable alternative to the policy we have been pursuing. In the case of all the proposals we have examined, the remedy has always been worse than the disease. The best way to reduce our gold inflow on commodity and service account is for us to have full recovery so that our imports will rise more rapidly than our exports.

These are sensible comments. The Secretary attributes the heavy gold imports of the past five years in part to political and economic uncertainties existing in Europe, which obviously is true, but it should not be overlooked that our

act of devaluation was itself responsible for some of the uncertainty involving other currencies and hence contributed to the gold inflow.

Clearly a rate of inflow on the scale described is undesirable from the standpoint of either the United States or the rest of the world. In 1935 the Federal Reserve Act was amended by Congress on the advice of the Federal Reserve Board, authorizing the Board to double the required reserves of member banks, as a precautionary measure against inflation. The increased reserves became effective in 1937. In December, 1936, the Treasury adopted the policy of "sterilizing" further gold acquisitions by setting them apart in an "inactive fund," instead of issuing gold certificates against them. These precautions have reflected official opinion that the volume of incoming gold was a menace to the stability of the banking and business situation.

In view of a gold stock now exceeding $15,000,000,000, and the continuing rate of imports, would it be advisable, under any foreseeable circumstances, to put into effect another devaluation of the dollar? It would increase gold imports and lead to a further round of devaluations. Moreover, a devaluation of the dollar to the full 50 per cent permitted by law would mean raising the price of gold still further, to $41.34 an ounce, thus adding slightly more than 18 per cent, or $2,750,000,000, to the value of United States' gold holdings.

Another fact of importance is that the increase of the buying price for gold by the United States and other governments has stimulated gold production and it is increasing rapidly. The price increase has exceeded the cost increase up to this time and made it possible to work ores of lower grades. Thus the gold resources of the earth are being exploited more rapidly than ever before, and monetary gold stocks are becoming embarrassingly large.

The Emergency Use

The principal argument for extending the authority is that the power to devalue could be used in case rival nations should undercut the dollar. The first comment is a word of caution against the justification that "others do it," which is one of the most insidious and demoralizing appeals in common use. If accepted as valid there would be no real standard of conduct. Moreover, most peoples know by this time that nothing can be gained by competition in currency depreciation, and are eager to find a hitching post or some footing on which a stand may be made. This was the purpose of the Tripartite Agreement, and although this compact has been beset by difficulties, it sounded the keynote for unified action. It appealed for cooperation in the "reestablishment of a lasting equilibrium between the various economic systems."

The United States is equipped with the resources to serve as a "hitching post," or rallying point, for unified action. Since all countries have this interest in common, it is unlikely that any will desire to undercut a strong co-operating group. Surely, the United States does not want that role.

And, finally, it is to be said that all evidence shows that a depreciated currency is competitive *only while it is depreciating;* in other words, it is not a permanent competitor. If it stabilizes, the differences in costs which gave it an advantage will be gradually eliminated and the advantage lost. Should the United States, with its productive capacity and more than one-half the gold in the world, fear competition of this kind or have its policy shaped thereby?

Profits of Leading Companies, 1937-38

With the publication of a large number of additional corporate reports for 1938 during the past month, earnings figures are now available for most of the leading corporations in the various divisions of business. A tabulation of the statements of 2,435 companies shows combined net profits, less deficits, of approximately $2,134,000,000 in 1938, compared with $4,031,000,000 for the same companies in 1937, representing a decline of 47 per cent. These companies have an aggregate net worth or shareholders' equity of around $56,000,000,000, upon which the annual profits were at the rate of 3.8 per cent in 1938, against 7.2 per cent in 1937. The relative decline of profits by major divisions, and the average rate of return on net worth, were as follows:

Summary of Net Profits of Leading Corporations in 1937-38
(In Millions of Dollars)

No.	Division	Net Profits 1937	Net Profits 1938	% Change 1937-38	% Return 1937	% Return 1938
1,410	Manufacturing	$2,481	$1,139	—54	10.8	4.8
127	Mining & quar.....	216	114	—47	8.7	4.6
214	Transportation	100	D-146	....	0.7	....
157	Other utilities	567	505	—11	6.6	5.9
145	Trade	191	150	—21	10.9	8.4
86	Service & constr.	44	27	—39	7.2	4.4
296	Finance	437	345	—21	8.6	7.0
2,435	Total	$4,031	$2,134	—47	7.2	3.8

D- Deficit. * Before certain charges.

A more detailed summary, classified in over 60 industrial groups, is given in the next table, and shows the general trend of earnings in a broad cross-section of American business. In interpreting the figures, it should be borne in mind that published reports are more representative of conditions in the mass production industries than in the trades and services carried on chiefly by small concerns. Moreover, as has been pointed out repeatedly in connection with these tabulations, the financial results of leading companies are always better than

PROFITS OF LEADING CORPORATIONS FOR THE YEARS 1937 AND 1938

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends. — Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industrial Groups	Net Profits Years 1937	1938	Per Cent Change	Net Worth January 1 1937	1938	Per Cent Return 1937	1938
21	Baking	$ 23,871	$27,092	+13.5	$ 313,596	$ 308,955	7.6	8.8
18	Dairy products	22,430	24,278	+ 8.2	288,014	287,567	7.8	8.4
22	Meat packing	18,819	D-5,853	—......	584,221	572,965	3.2	......
41	Sugar	27,413	1,894	—93.1	417,852	424,489	6.6	0.4
67	Misc. food products	90,900	91,627	+ 0.8	929,650	931,372	9.8	9.8
169	Total food products	183,433	139,038	—24.2	2,533,333	2,525,348	7.2	5.5
13	Soft drinks	29,309	30,480	+ 4.0	76,073	83,391	38.5	36.6
34	Brewing	10,908	12,307	+12.8	76,643	82,439	14.2	14.9
16	Distilling	15,710	11,977	—23.8	92,059	101,630	17.0	11.8
63	Total beverages	55,927	54,764	— 2.1	244,775	267,460	22.8	20.5
24	Tobacco products	95,532	91,723	— 4.0	736,879	736,197	12.9	12.4
45	Cotton goods	14,176	D-6,305	—......	302,150	281,775	4.7	......
13	Silk and rayon	12,428	5,233	—57.9	111,798	116,123	11.1	4.5
9	Woolen goods	D-906	D-6,208	—......	96,018	92,934	......	......
24	Knitted goods	4,415	3,033	—31.3	62,716	61,780	7.0	4.9
38	Misc. textile products	22,897	D-352	—......	260,007	257,321	8.8	......
129	Total textile products	53,010	D-4,599	—......	832,689	809,933	6.4	......
27	Clothing and apparel	6,885	2,856	—58.5	108,261	111,797	6.4	2.6
8	Leather tanning	1,833	D-4,754	—......	53,247	50,110	3.4	......
20	Shoes, etc.	12,969	7,317	—43.6	183,324	182,239	7.1	4.0
28	Total leather products	14,802	2,563	—82.7	236,571	232,349	6.3	1.1
29	Rubber products	30,104	24,641	—18.1	471,828	480,935	6.4	5.1
36	Wood products	16,602	3,127	—81.1	147,658	163,752	11.2	1.9
65	Paper products	43,739	18,306	—58.1	585,968	611,446	7.5	3.0
33	Printing and publishing	14,999	8,290	—44.7	183,059	180,058	8.2	4.6
44	Chemicals—industrial, etc.	213,602	122,574	—42.6	1,456,018	1,555,842	14.7	7.9
25	Drugs	62,357	52,704	—15.5	339,016	350,089	18.4	15.1
8	Fertilizer	5,946	2,782	—53.2	78,851	80,744	7.5	3.4
13	Paint and varnish	17,752	7,359	—58.5	210,329	213,305	8.4	3.4
90	Total chemical products	299,657	185,419	—38.1	2,084,214	2,199,980	14.4	8.4
47	Petroleum products	471,299	250,888	—46.8	4,695,445	4,972,115	10.0	5.0
59	Stone, clay and glass	76,459	36,621	—52.1	659,165	671,121	11.6	5.5
60	Iron and steel	226,794	D-7,379	—......	3,295,279	3,451,486	6.9	......
13	Agricultural implements	67,153	36,217	—46.1	511,998	546,035	13.1	6.6
41	Building equipment	37,679	1,591	—95.8	373,741	394,481	10.1	0.4
61	Electrical equipment	144,380	55,082	—61.8	951,978	961,326	15.2	5.7
53	Hardware and tools	48,326	13,563	—71.9	293,075	307,788	16.5	4.4
43	Household equipment	22,935	8,277	—63.9	156,999	163,463	14.6	5.1
111	Machinery	78,004	29,472	—62.2	538,542	571,067	14.5	5.2
20	Office equipment	44,253	23,602	—46.7	219,042	232,506	20.2	10.2
28	Railway equipment	53,796	D-5,797	—......	703,976	728,076	7.6	......
25	Aircraft and parts	7,778	18,169	+......	107,978	117,470	7.2	15.5
53	Misc. metal products	54,359	24,974	—54.1	507,881	508,533	10.7	4.9
508	Total metal products	785,457	197,771	—74.8	7,660,489	7,982,231	10.3	2.5
29	Motor vehicles (complete)	254,672	101,951	—60.0	1,375,457	1,397,694	18.5	7.3
52	Motor vehicle parts	47,179	2,951	—93.7	263,383	275,843	17.9	1.1
81	Total motor vehicles	301,851	104,902	—65.2	1,638,840	1,673,537	18.4	6.3
22	Misc. manufacturing	31,629	22,207	—29.8	248,146	258,113	12.7	8.6
1,410	Total manufacturing	$2,481,385	$1,138,517	—54.1	$23,067,320	$23,876,372	10.8	4.8
25	Coal mining	1,244*	D-5,768*	—......	412,341	411,612	0.3	......
45	Metal mining	182,286*	96,727*	—46.9	1,771,953	1,748,451	10.3	5.5
46	Oil and gas	20,522*	15,352*	—25.2	224,228	234,745	9.2	6.5
11	Misc. mining, quarrying	12,048*	7,673*	—36.3	89,287	89,817	13.5	8.5
127	Total mining & quar.	216,100*	113,984*	—47.3	2,497,809	2,484,625	8.7	4.6
141	Class 1 railroads	98,671	D-122,912	—......	13,617,853	13,248,547	0.7	......
28	Traction and bus	D-9,015	D-24,646	—......	564,431	556,218	......	......
9	Shipping	1,797	D-1,041	—......	82,057	79,889	2.2	......
36	Misc. transportation (a)	3,496	2,765	—20.9	150,719	154,012	2.3	1.8
214	Total transportation	94,949	D-145,834	—......	14,415,060	14,038,666	0.7	......
90	Electricity, gas, etc. (b)	345,461	322,997	— 6.5	5,304,231	5,382,016	6.5	6.0
55	Telephone and telegraph	209,334	171,876	—17.9	3,173,171	3,123,776	6.6	5.5
12	Misc. utilities (c)	12,057	10,618	—11.9	77,952	78,582	15.4	13.5
157	Total public utilities	566,852	505,491	—10.8	8,555,354	8,584,374	6.6	5.9

PROFITS OF LEADING CORPORATIONS FOR THE YEARS 1937 AND 1938—Continued

No.	Industrial Groups	Net Profits Years 1937	Net Profits Years 1938	Per Cent Change	Net Worth January 1 1937	Net Worth January 1 1938	Per Cent Return 1937	Per Cent Return 1938
18	Chain stores—food	11,382	13,338	+17.2	196,422	193,451	5.8	6.9
49	Chain stores—other	101,486	79,465	—21.7	661,308	702,934	15.3	11.3
31	Department stores	10,632	7,636	—28.2	244,355	242,037	4.4	3.2
5	Mail order	53,148	44,346	—16.6	436,897	457,537	12.2	9.7
42	Wholesale & misc.	13,941	5,698	—59.1	202,116	202,264	6.9	2.8
145	Total trade	190,589	150,483	—21.0	1,741,098	1,798,223	10.9	8.4
20	Amusements	34,943	21,211	—39.3	371,531	368,336	9.4	5.8
21	Restaurant and hotel	1,040	D-1,037	—......	82,328	80,070	1.3	......
26	Other business services	6,058	3,167	—47.7	83,693	85,429	7.2	3.7
19	Construction (d)	2,107	3,382	+60.5	77,449	75,139	2.7	4.5
86	Total service & construction	44,148	26,723	—39.4	615,001	608,974	7.2	4.4
73	Commercial banks	187,546	176,113	— 6.1	2,232,797	2,276,098	8.4	7.7
74	Insurance companies (e)	81,886	75,058	— 8.3	940,721	803,067	8.7	9.3
79	Investment companies (f)	95,857	39,478	—58.8	1,390,066	1,246,632	6.9	3.2
31	Sales finance companies	72,352	54,916	—24.1	405,040	433,404	17.9	12.7
39	Real estate companies	D-664	D-457	—......	137,485	138,045	......	......
296	Total finance	436,977	345,108	—21.0	5,106,109	4,897,246	8.6	7.0
2,435	Grand total	$4,031,000	$2,134,472	—47.0	$55,997,751	$56,288,480	7.2	3.8

D- Deficit. * Before certain charges. (a) Includes air transport, stockyards, docks, warehousing, etc. (b) Figures refer to shareholders only. Because of the large proportion of bonded indebtedness, actual return on the property investment is less than the above. (c) Includes pipe lines, radio broadcasting. (d) Includes shipbuilding. (e) Fire and casualty. Figures represent underwriting gain, and net interest, dividends and rents earned. (f) Net income shown as reported, not including such profits or losses on investments sold as were carried directly to surplus or reserve, nor changes in market value of portfolios.

the average for business as a whole, as later shown in the Treasury "Statistics of Income" covering all corporations, but only available after a delay of about two years.

In the summary it will be observed that only 6 out of the 40 manufacturing groups were able to show an improvement in earnings last year. These were the baking, dairy and miscellaneous food product, soft drink and brewing groups, all of which had lower costs for materials; and aircraft, which had a marked increase in sales.

The factors chiefly responsible for the sharp decline in profits of most manufacturing companies—decreased volume of business, lower sales prices, higher unit labor costs, increases in certain kinds of taxes (including social security taxes) and write-downs of inventory and investments—affected also the earnings in lines other than manufacturing.

Lower Margins of Profit

The rates of net profit to sales last year of 780 manufacturing and trade corporations, having sales of $1,000,000 and upwards, are given in the following table, together with comparative rates for the preceding year. For the 680 manufacturers, having combined sales of almost $17,000,000,000, the combined net profit (including investment and miscellaneous income) was at the rate of 4 per cent on sales last year, against 7.4 per cent in 1937. About one-third of the individual companies, however, had no return on sales or invested capital, but net deficits instead.

Net Profit on Sales of Leading Corporations in 1937 - 1938

(In Thousands of Dollars)

No.	Manufacturing	Sales 1938	Profits* 1938	Profits to Sales 1938	Profits to Sales 1937
18	Baking	$ 876,285	$ 24,505	6.5	5.6
11	Dairy products	753,700	23,523	3.1	2.7
18	Meat packing	2,320,986	D-6,637	D-0.3	0.7
29	Sugar	288,568	1,821	0.6	6.4
33	Food products—misc.	656,011	51,252	7.8	5.4
30	Beverages	243,999	23,048	9.4	9.1
13	Tobacco products	928,716	83,209	9.0	8.7
25	Cotton goods	210,558	D-6,042	D-2.9	3.2
43	Textile products—other	343,437	D-5,013	D-1.5	2.9
14	Shoes	238,910	6,892	2.9	4.5
20	Rubber products	678,216	24,462	3.6	3.4
25	Paper products	213,837	4,051	1.9	7.1
26	Chemicals	359,702	24,118	6.7	15.0
13	Drugs	429,273	40,458	9.4	8.7
27	Petroleum products	1,318,652	73,810	5.6	11.4
20	Stone, clay and glass	282,216	17,056	6.0	9.9
35	Iron and steel	1,649,217	D-9,304	D-0.6	7.5
8	Agricultural implements	377,678	23,223	6.1	11.0
22	Building equipment	288,541	3,903	1.4	8.3
26	Electrical equipment	868,157	54,340	6.3	12.1
23	Household equipment	142,520	5,544	3.9	9.3
40	Machinery	284,901	11,758	4.1	9.1
13	Office equipment	243,837	21,577	8.8	13.9
58	Metal products—other	769,641	39,065	5.1	9.2
18	Motor vehicles (complete)	1,761,650	105,947	6.0	9.5
15	Motor vehicle parts	150,383	D-1,115	D-0.7	6.8
62	Misc. manufacturing	710,881	31,879	4.5	7.9
680	Total manufacturing	$16,890,472	$667,325	4.0	7.4
	Trade				
14	Chains—food	932,730	10,642	1.1	0.9
39	Chains—other	1,518,911	77,782	5.1	6.2
22	Department stores	352,477	7,133	2.0	2.0
5	Mail order	996,038	44,346	4.5	5.1
20	Wholesale, etc.	318,200	6,388	2.0	2.7
100	Total trade	4,118,356	146,291	3.5	3.6
780	Total mfg. and trade	$21,008,828	$813,616	3.9	6.6

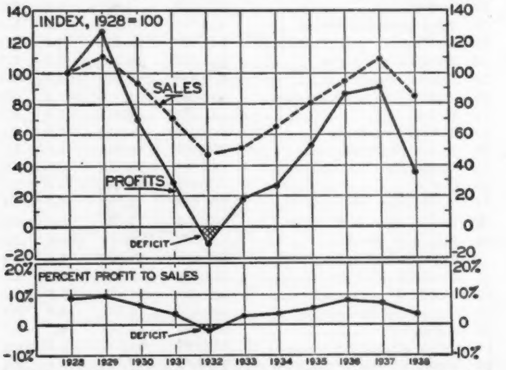
D—Deficit. * Including investment and miscellaneous income.

In the merchandising industries the trend also was toward narrower margins of profit last year. For the 100 merchandising corporations, with sales of over $4,000,000,000, the combined net profit was at the rate of 3.5 per cent last year, against 3.6 per cent in 1937. Although the food chains showed a slight improvement, their actual margin of profit (including non-operating income) represented only 1.1 cents per dollar of sales in 1938, against $\frac{9}{10}$ of 1 cent in 1937.

The Showing of 50 Large Companies

The violent fluctuations in sales and profits to which the manufacturing industries have been subject during the past ten years may be seen on the accompanying chart, which is computed from reports of 50 of the largest companies for which sales figures are available back to 1928.

While the group is small numerically, the companies are all outstanding organizations in major industries, including food and packing, metals and equipment, automobiles, petroleum, rubber, shoes, textiles, etc., their combined sales totaling roughly one-sixth of the total for all manufacturing corporations in the United States. In order to compare the relative movements of sales and profits, both series are shown in the chart as percentages of the year 1928 taken as 100, and the dollar figures are given below for reference. In these comparisons allowance should be made for a greater than average growth (partly because of mergers) of these leading companies.



Sales and Net Profits of 50 Large Mfg. Corp., 1928=100. Also % Profit to Sales.

50 Large Manufacturing Corporations
(In Millions of Dollars)

Year	Sales	Profits	%	Year	Sales	Profits	%
1928....	$ 9,998	$ 876	8.8	1934....	$ 6,469	$231	3.6
1929....	11,074	1,073	9.7	1935....	8,010	456	5.7
1930....	9,316	608	6.5	1936....	9,476	759	8.0
1931....	7,006	250	3.6	1937....	10,937	791	7.2
1932....	4,707	D-95	D-2.0	1938....	8,466	309	3.6
1933....	5,103	149	2.9				

D- Deficit.

These results would tend to confirm the impression that the recovery in sales from the low point of the depression has exceeded that of net profits. In 1937, for example, sales were about 9 per cent higher than in 1928, but profits were 10 per cent lower. In 1938, sales were 15 per cent lower than in 1928, but profits were 65 per cent lower. Last year's sales were slightly above the 1935 level, but profits were considerably below. Evidence appears also that profits — a residual and small item relative to total turnover—are determined not only by the level of business, but by the direction in which business is moving. This is particularly true on the downward cycle, because of inventory and other losses. In 1936, for example, the level of sales by these 50 companies was practically the same as in 1930, yet profits in 1936, when business and prices were rising, were considerably higher than in 1930, when business and prices were falling.

Changes in Working Capital

An analysis of the year-end balance sheets of the same manufacturing corporations used for the chart shows some interesting changes in working capital position last year. Following is a condensed summary of the current assets and current liabilities at the end of the two years:

Working Capital of 50 Large Mfg. Corp.
(In Millions of Dollars)

	End of Fiscal Year 1937	End of Fiscal Year 1938	Change Amount	Change Per Cent
Cash & mkt. securities	$ 774	$1,140	+366	+47
Mdse. inventories	2,174	1,832	—342	—16
Receivables, etc	749	742	— 7	— 1
Total current assets	3,697	3,714	+ 17	+ 1
Total current liabil...	959	741	—218	—23
Working capital	2,738	2,973	+235	+ 9
Current ratio	3.86	5.01		

It will be seen that the holdings of cash and marketable securities were built up during the last year by slightly more than merchandise inventories were liquidated, with little change in accounts and notes receivable, etc., so that total current assets increased $17,000,000. Total current liabilities, however, including accounts and notes payable, accruals and reserves, were reduced by $218,000,000. As a result, there was a gain of $235,000,000 in working capital, while the familiar "current ratio" rose from 3.86 to 5.01.

The rise in net current assets last year, despite the sharp drop in profits, is explained by the fact that (1) dividends were cut or omitted by numerous companies having profits, so as to retain at least some surplus in the business; (2) some companies in the group issued long-term obligations or new stock, and used the proceeds for working capital among other purposes; and (3) some of the operating charges were for depreciation and depletion reserves, and thus did not involve cash outlay.

Merchandise inventories were reduced last year in almost the same proportion that sales declined. The strengthened cash position indicates that any increase in bank borrowings is likely to be slow, unless reasons for carrying larger inventories appear. However, the cash and working capital position of these 50 companies is undoubtedly stronger than that of the average manufacturing corporation.

Railroad and Other Transportation

Gross and net earnings of the railroads last year declined sharply, and after payment of taxes and interest charges the 141 class 1 systems had a combined net loss of $123,000,000, upon the shareholders' investment of over $13,000,000,000, compared with a net income of $99,000,000 in 1937. The deficit was the largest for any year in the history of American railroads, with the single exception of 1932. One-third of the total railroad mileage is now being operated by receivers.

Due to the recession in general business, railroad freight revenues declined 15 per cent last year, while passenger revenues declined 8 per cent. Expenses for operating and maintenance were reduced sharply, but not sufficiently to offset the loss in revenues, while total tax accruals actually increased, to $341,000,000, due to payroll taxes. During the first quarter of 1939, however, operating results have made a much more favorable showing. Gross revenues have increased moderately over those of a year ago, and the deficit after charges has been reduced sharply.

The 26 traction and bus systems in our tabulation, including a number in receivership, had a decrease of 4 per cent in gross revenues last year, which, combined with higher operating expenses and higher taxes, increased their net deficit from $9,000,000 in 1937 to $24,000,000 in 1938.

Other Public Utilities

Last year 90 of the larger systems supplying electric light and power, gas and other services had a decrease of less than 1 per cent in gross revenues, but a decrease of 6 per cent in net income, because of higher operating expenses and the continued rise in taxes.

Because of the introduction of many new federal, state and local taxes in recent years, including temporary and emergency taxes, social security and unemployment taxes, and the increase in rates of older taxes, the total of taxes imposed on public utility companies has become one of their major costs of doing business. Increased taxes have offset to considerable extent the economies brought about through the investment of new capital in central station and distribution equipment, the increase in capacity of generators, the increased efficiency in fuel consumption, and the saving of interest through refunding of bond issues. Although rates charged consumers have been lowered repeatedly, still greater reductions would have been possible were it not for the heavy increase in taxes.

In 1938, for example, the Consolidated Edison Company of New York paid eighteen principal types of taxes which aggregated $51,353,568, or nearly $1,000,000 per week. Last year's total compares with $49,312,587 in 1937 and $25,559,970 in 1929. Taxes last year amounted to 21.4 per cent of gross operating revenues, and were equivalent to $4.48 per share on the company's common stock. They were 51 per cent larger than the dividends paid on all outstanding stocks.

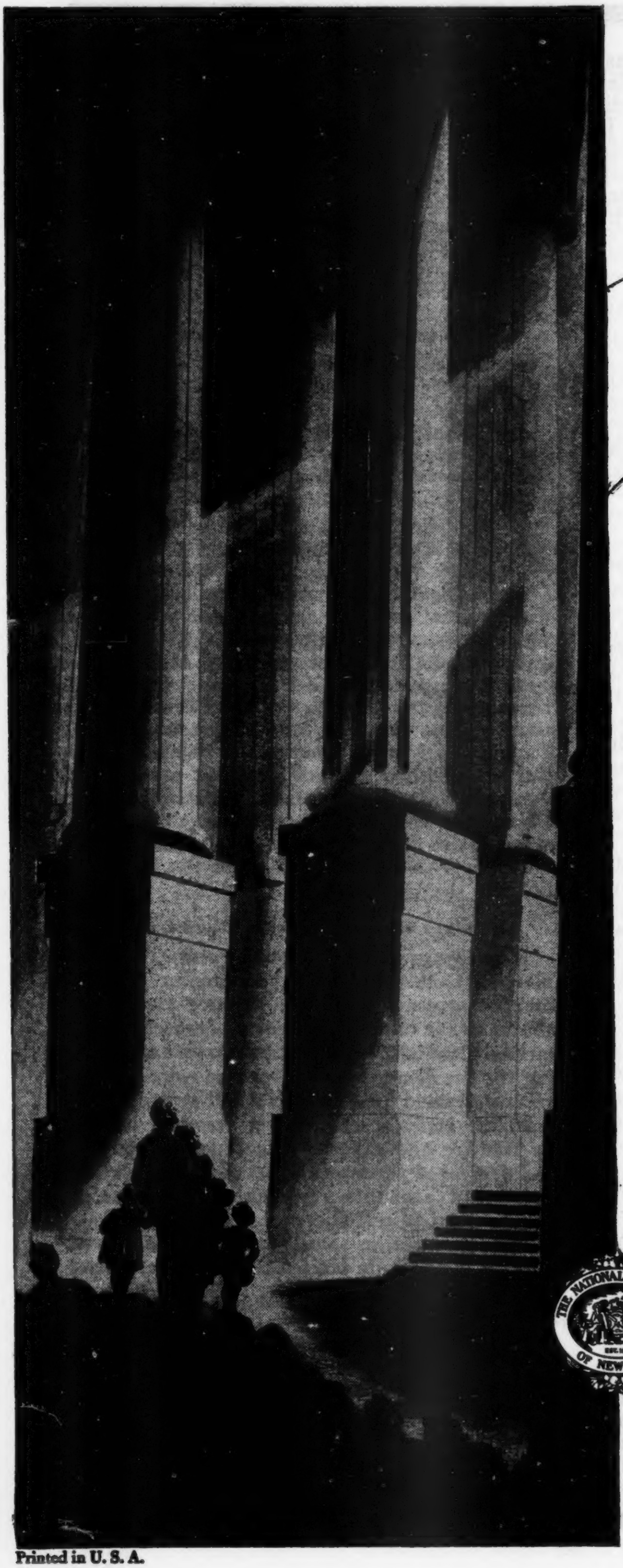
Telephone and telegraph systems last year had operating results somewhat similar to those of the electric power and gas industries. Gross revenues of 55 leading systems in 1938 were practically the same as in 1937, but rising wages and taxes caused a decline of 18 per cent in net income.

Taxes paid by the American Telephone & Telegraph Company and its operating subsidiaries last year amounted to $147,400,000 and were $9,700,000 above those of 1937, despite the decline in net income. Operating revenues of the Bell System in 1938 were practically equal to those of 1929, but taxes were 74 per cent larger, and net income was 24 per cent smaller. Taxes last year were equal to about 80 cents per month per telephone, or 14 per cent of the average telephone bill. They were at the rate of $7.54 for each share of the company's stock outstanding in the hands of 647,000 shareholders.

Earnings of Financial Corporations Lower

Earnings of most of the representative commercial banks, insurance companies, investment companies and sales finance companies shown in the tabulation were moderately lower in 1938 than in 1937. Principal factors accounting for the decrease in net income were the decreased demand for commercial and secured loans from the banks, decreased net premium income by the fire and casualty insurance companies and decreased purchases of retail and wholesale notes and accounts receivable by the sales finance companies. There were further declines in interest rates on some types of loans, lower interest yields from United States Government and other bonds and reduced dividends from stocks.

In the tabulation given for financial companies, the net income as reported does not include such charge-offs and recoveries on loans, or profits and losses on investments sold as were carried directly to surplus or reserves, nor the changes in market value of portfolios.



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